

HOUSE BILL REPORT

EHB 1069

As Passed Legislature

Title: An act relating to performance audits of tax preferences.

Brief Description: Requiring performance audits for tax preferences.

Sponsors: By Representatives McIntire, Conway, Priest, Upthegrove, Kilmer, Moeller, Dickerson, Williams, Schual-Berke, Nixon, Springer, Sells, P. Sullivan, Green, Lovick, Kenney, Haigh, Wallace, Kagi, Simpson, Linville, Morris, Wood, Hunter, Lantz, Hudgins, Ericks, Darneille, Clibborn, Sommers, Morrell, Takko, O'Brien, Appleton, Hunt, Santos, Ormsby, Murray and Chase.

Brief History:

Committee Activity:

Finance: 1/19/05, 1/26/05 [DP].

Floor Activity:

Passed House: 2/7/05, 63-32.

Floor Activity:

Passed House: 2/11/06, 61-34.

Passed Senate: 3/3/06, 33-15.

Passed Legislature.

Brief Summary of Engrossed Bill

- Creates a citizen commission to develop a schedule for periodic review of tax preferences such as exemptions, exclusions, deductions, credits, deferrals, and preferential rates.
- Requires the Joint Legislative Audit and Review Committee to conduct the actual reviews of tax preferences according to criteria set in the bill.
- Requires annual reports to the Legislature on reviewed tax preferences.

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 5 members: Representatives McIntire, Chair; Hunter, Vice Chair; Conway, Hasegawa and Santos.

Minority Report: Do not pass. Signed by 3 members: Representatives Orcutt, Ranking Minority Member; Ahern and Roach.

Staff: Bob Longman (786-7139).

Background:

Tax exemptions, exclusions, deductions, credits, deferrals, and preferential rates are known as tax preferences. The Department of Revenue (Department) publishes a report on tax preferences every four years. The report covers more than 400 tax preferences and describes each preference, the year of enactment, the purpose of the preference (or the Department's best estimate of the purpose), an indication of primary beneficiaries, and estimated fiscal impact.

In 1982 the Legislature enacted legislation that initiated a sunset review of tax preferences. The legislation directed the Joint Select Committee on Sunset Review to prepare a bill that would terminate all tax preferences over a period of four years. If this termination bill had been enacted, the Legislative Budget Committee would have been required to review each preference before its termination date and report back to the Legislature. The termination and review bill was not enacted, and the Legislative Budget Committee did not conduct tax preference reviews. The Legislative Budget Committee is now known as the Joint Legislative Audit and Review Committee (JLARC).

Summary of Engrossed Bill:

The Legislature recognizes that tax preferences are intended to be in the public interest. The Legislature finds that periodic review of tax preferences is needed to determine if their continued existence will serve the public interest.

The Citizen Commission for Performance Measurement of Tax Preferences (Commission) is created, with two nonvoting members and five voting members. The state auditor and the chair of the Joint Legislative Audit and Review Committee are nonvoting members. The chair of each of the two largest caucuses of the Senate and the two largest caucuses of the House of Representatives shall each appoint a voting member. None of these appointees may be members of the Legislature. The Governor shall select the seventh member.

The Commission must develop a schedule for review of tax preferences at least once every 10 years. The Commission is to schedule all tax preferences for review, except those required by constitutional law, those the Commission determines are a critical part of the structure of the tax system, the small business and occupation tax credit, sales and use exemptions for food and prescription drugs, property tax relief for retired persons, property tax valuations based on current use, and tax exemptions for machinery and equipment for manufacturing, research and development, or testing. An expedited review may be provided for tax preferences with an estimated biennial fiscal impact of \$10 million or less. The Commission must provide a process for effective citizen input during its deliberations.

The JLARC must review tax preference according to the 10-year schedule developed by the Commission. The JLARC is to consider, but not be limited to, the following factors in the review:

- (a) the classes of individuals, types of organizations, or types of industries whose state tax liabilities are directly affected by the tax preference;
- (b) public policy objectives that might provide a justification for the tax preference, including the extent to which the preference encourages business growth or relocation into this state, promotes growth or retention of high wage jobs, or helps stabilize communities;
- (c) evidence that the existence of the tax preference has contributed to the achievement of any of the public policy objectives;
- (d) the extent to which continuation of the tax preference might contribute to any of the public policy objectives;
- (e) the extent to which terminating the tax preference may have negative effects on beneficiaries of the tax preference, and the extent to which resulting higher taxes may have negative effects on employment and the economy;
- (f) the extent to which the tax preference may provide unintended benefits to an individual, organization, or industry;
- (g) the feasibility of modifying the preference to provide for adjustment or recapture of the tax benefits of the preference if the objectives are not fulfilled;
- (h) fiscal impacts of the tax preference, including past impacts and expected future impacts if it is continued;
- (i) the extent to which termination of the tax preference would affect the distribution of liability for payment of state taxes; and
- (j) consideration of similar tax preferences adopted in other states, and potential public policy benefits that might be gained by incorporating corresponding provisions in Washington.

For each tax preference, the JLARC must provide a recommendation as to whether the tax preference should be continued without modification, modified, scheduled for sunset review at a future date, or terminated immediately. The JLARC may recommend accountability standards for the future review of a tax preference.

The JLARC will submit a report to the Commission by August 30 of each year. The Commission may review and comment on the JLARC report. The JLARC must prepare a final report that includes any comments of the Commission and submit the report to the House Finance and Senate Ways & Means Committees by December 30. The legislative committees are to hold a joint hearing on the report.

The first report of the JLARC is due by August 30, 2006. The first report of the Commission to the Legislature is due by December 30, 2006. A special report on a shorter time line is required for tax preferences that expire before January 1, 2007. The JLARC must submit this special report to the Legislature by January 12, 2006.

Staff support to the Commission is provided by the JLARC, and the Department of Revenue and Employment Security Department are directed to provide information needed by the Commission or JLARC.

Statutes relating to the unimplemented 1982 tax preference review are repealed.

Appropriation: None.

Fiscal Note: Requested on January 11, 2005.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: Washington needs to remain competitive with tax incentives. A consistent, systematic review to see if the incentives work is important. If an incentive isn't working it should be fixed or taken off the books. Concentrate the state's fiscal resources on incentives that do work and do bring in jobs to this state. This bill is a good approach because it separates the review from the legislative process by doing the work outside the legislative session. Tax exemptions should be reviewed in light of available state resources and the changing state economy. With our tax system, public revenues cannot keep pace with the need for public services. The public has a right to know how public money is spent. Performance audits of exemptions will help the Legislature and public determine which exemptions are serving the public good. Some exemptions are loopholes that give state money to wealthy people and corporations. These funds could be better used for tax relief for low-income people who have unfairly high tax burdens. Government programs such as community colleges have full accountability for how money is spent. There should be accountability for tax exemptions, too. Tax exemptions are hidden government spending. Just as government should prioritize government expenditures, it should prioritize tax exemptions. There are concerns that this process will duplicate other reports that are given to the Department of Revenue for some incentives. The Commission should have members who are consumer advocates.

Testimony Against: None

Persons Testifying: (In support) Ron Newbry, Washington Economic Development Association; Michael Tracy, Grays Harbor Economic Development Council; Shawn Cantrell, Washington Citizen Action; Steve Zemke, Taxpayers for Washington's Future; Marilyn Watkins, Economic Opportunity Institute; Michelle Hagen, Washington Association of County Officials and Washington Association of County Assessors; Paul Parker, Washington

Association of Counties; Janet Rodriguez, SEIU 775; and Lynn Dodson, Seattle Community College Federation of Teachers.

(Neutral with concerns) Lew McMurrin, Washington Software Alliance.

Persons Signed In To Testify But Not Testifying: None.